EME COURT

74-791

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In the

Supreme Court of the United States

OCTOBER TERM, 1974

No. B-4556

GEORGE W. SIBLEY, M.D.,
Petitioner,

v.

HORN ADVERTISING, INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CIVIL APPEALS, 5th SUPREME JUDICIAL DISTRICT OF TEXAS

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TABLE OF CONTENTS

	Page
Table of Authorities	ii
Jurisdiction	1
Judgments Below	1, 2
Statement of Facts	2
Questions Presented	6
Statutes Involved	7
Reasons for Granting the Writ	10
Conclusion	15
Certificate of Service	16
Appendix A: Confidential Memorandum	A-1
Appendix B: Opinion of the Court of Civil Appeals of the Fifth Supreme Judicial District	B-1
Appendix C: Order of the Supreme Court of Texas refusing writ og error and overruling motion for rehearing	C-1

Statutes Page

Section 10(b), 1034 Securities Exchange Act; 15 U.S.C. § 78j(b) 5, 8, 15

Section 12, 1933 Securities Act; 15 U.S.C. § 77l 5, 7, 13, 15
Section 17, 1933 Securities Act; 15 U.S.C. § 78q 5, 7

Rule 10b-5, 1934 Securities Exchange Act; 17 C.F.R. § 240.10b-5 ..... 5, 9, 15

Tex. Rev. Civ. Stat. Ann. art. 581 § 33A 5, 9

Cases

Affiliated Ute Citizens of Utah v. United States, 92 S. Ct. 1456 (1972) 13

Henderson v. Hayden Stone, Inc., 461 F. 2d 1069 (5th Cir. 1972) 12

Hill York Corporation v. American International Franchises, Inc., 448 F. 2d 680 (5th Cir. 1971) 12

Mills v. Electric Auto-Lite Co., 296 U.S. 375 (1970) 14

S.E.C. v. Continental Tobacco Company of South Carolina, Inc., 463 F. 2d 137 (5th Cir. 1972) 12

S.E.C. v. Ralston Purina Company, 346 U.S. 119 (1953) 12

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JURISDICTION

This case has been reviewed by the highest court of the State of Texas, the Texas Supreme Court. This Court is petitioned because there were violations of the 1933 Securities Act and the 1934 Securities Exchange Act. Telephone calls were made to Sibley in connection with the execution of the subscription agreement, the U.S. mails were used, and thus there is no question of jurisdiction. The use of jurisdictional means in connection with this transaction was established in the Texas courts.

JUDGMENTS BELOW

The 192nd Texas District Court of Dallas County, Texas,

entered a final judgment on June 13, 1973, in favor of the Defendant.

The Texas Court of Civil Appeals for the 5th Supreme Judicial District of Texas upheld the judgment of the District Court in an opinion dated January 24, 1974. (See Appendix B)

The Supreme Court of Texas denied Sibley's petition for writ of error (no reversible error), and denied Sibley's motion for rehearing on July 24, 1974. (See Appendix C)

STATEMENT OF FACTS

George W. Sibley, M.D. ("Sibley") petitions for writ of certiorari for a review of the treatment by the Texas courts of the question of whether contract for the purchase of securities violating the federal securities laws may be enforced by state courts.

Horn Advertising, Inc. (hereinafter called "Horn"), a now defunct Texas corporation which is the assignee of an equally defunct Texas corporation named Computer Saver Services, Inc. (hereinafter called "Computer"), filed suit against Sibley. Computer was incorporated under the laws of the State of Texas in 1969 and was formed for the purpose of providing monthly accounting services to individuals on a basis similar to that provided for business. Its principals included Robert Fanning, a Dallas attorney, and Keith Laseter, a promoter.

The stock of Computer was and is unregistered, and no applications for registration or exemption from registration were made by the corporation under any provision of the State or Federal Securities Acts.

Sibley, the Petitioner herein, was included in a list of names of prospects furnished to Laseter by Fanning. Laseter contracted some nineteen or twenty prospective investors, including Petitioner, for the purpose of soliciting a purchase by them of Computer's unregistered stock. All but one or two of the persons solicited signed a subscription agreement, and all of those who signed, except Sibley, paid their subscription money to Computer.

After a suggestion by Fanning to Sibley that he ought to obtain at least an option to buy stock in Computer, (which company Fanning represented), because, according to Fanning, the stock was soon to go public, Laseter came by Sibley's office for the purpose of soliciting Sibley's purchase of such stock. Sibley, an orthopedic surgeon who was quite busy with patients at the time of Laseter's visit, called Fanning and asked him whether or not the documents which Laseter sought to have him sign were for the purpose of obtaining the option they had discussed several days previously. Assured by Fanning that such was the case, Sibley signed what turned out to be a subscription agreement binding him to pay $10,000 for the purchase of Computer stock.

Prior to signing the subscription agreement, Sibley was contacted by Laseter by telephone on a number of occasions in an attempt to make an appointment. The meeting which was ultimately held was without appointment. Although Sibley has no memory of being furnished any written materials in connection with the solicitation, Laseter claims to have presented to him a "confidential memorandum," a copy of which is attached hereto as Appendix A, a flip chart, which

contained, essentially, the same information contained in the memorandum and a "flyer" or brochure descriptive of Computer's services. After Petitioner's signature was obtained, a confirmation for acceptance was mailed to Petitioner by certified mail, return receipt requested. The presentation alleged to have been made to Petitioner by Laseter was the same type of presentation admitted to have been made to all persons who were solicited in connection with the offering.

The memorandum, flip chart, and flyer contained the sum and substance of the written documents furnished to Petitioner in connection with the Computer offering. The data contained in the written materials consisted primarily of future projections and contained nothing of a material nature pertaining to the financial condition of the company, the stock interest of the promoters and controlling parties (and the profits derived by such insiders from the sale of stock), the names and salaries of the officers and directors, the existence of any conflicts of interests, history of the business or any other material facts which might be of interest to a prospective investor, or the disclosure of which would be required in a registration statement or application for an exemption. Although the representation was made in the memorandum ". . . that obviously the corporation is a success . . .", it was disclosed during the trial before the Texas District Court in Dallas that Computer actually had no cash flow and no assets at the itme solicitation was in progress. Very shortly after Sibley had signed the subscription agreement in question, Computer became totally insolvent and ceased to function.

Several months after Computer ceased to function, Computer

assigned the subscription agreement in question to Horn, one of its creditors. Horn filed suit against Sibley, who defended the case on the grounds that the transaction sought to be enforced was done in violation of the Texas Blue Sky Law, Tex. Rev. Civ. Stat. Ann. art. 581: Section 12(2) and 17 of the 1933 Securities Act; and Section 10(b) and Rule 10b-5 under the 1934 Securities Exchange Act. A trial court judgment adverse to Petitioner was affirmed by the Court of Civil Appeals, and application for writ of error was denied, no reversible error, by the Texas Supreme Court. A copy of the opinion of the Texas Court of Civil Appeals for the 5th Supreme Judicial District is attached hereto as Appendix B. On October 24, 1974, this court extended the time to file a petition for writ of certiorari until December 21, 1974.

Many of the facts are contained in Appendix A and Appendix B. However, the following facts and omissions are pertinent.

Omissions of material facts:

The following facts deemed material by Sibley were not disclosed to him at the time he signed the subscription agreement:

1. Profits of the promoters;
2. Conflicts of interest between Sibley and Fanning and Laseter;
3. Names, backgrounds, and the experience of the officers and directors;
4. Salaries of the employees, especially the officers;
5. The existence of options to purchase stock in Computer held by both Laseter and Fanning;

6. Number of shares of Computer stock issued (vs. to be issued) and the number of shares outstanding;
7. The capitalization of Computer and its financial condition;
8. The basis for projections as to income, profits, expenses, and persons to be reached by advertising.

Misstatements of material facts:

The following facts were misstated to Sibley and they are material in Sibley's opinion: (See Appendix A and Appendix B)

1. The stock of Computer was going to be registered with the Securities and Exchange Commission and sold to the public;
2. Profits were anticipated and projected;
3. That Computer was an obvious success and could generate immense volumes of gross revenues as well as outstanding net profits on operations;
4. That television advertising (". . . possibly given by Paul Harvey . . .") would be used.

Under authorities hereinafter set forth, there is no question that the foregoing misstatements and omissions were material and in violation of the 1933 and 1934 Federal Securities Acts.

QUESTIONS PRESENTED

1. May the Texas courts impose liability upon Sibley when he executed a subscription agreement because of misstated material facts and omissions to state material facts, thus ignoring federal securities law?

2. May the federal securities acts be used in a defensive manner to refute liability under the law of the State of Texas

when the federal law, making a contract voidable, conflicts with the Texas Court's interpretation of the Texas statutes?

STATUTES (AND RULES) INVOLVED

Securities Act of 1933, Section 12:

Sec. 12. Any person who —

(1) offers or sells a security in violation of section 5, or

(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), or by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statments, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Securities Act of 1933, Section 17:

Sec. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly —

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shal be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newpaper, article letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

(c) The exemptions provided in section 3 shall not apply to the provisions of this section.

Securities Act of 1934, Section 10:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in

contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Securities Act of 1934, Rule 10b-5:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Texas Revised Civil Statutes Annotated, Article 581-33 A:

A. Any person who

(1) Offers or sells a security in violation of Sections 7, 9 (or any requirement of the Commissioner thereunder), 12, 23B or any order under 23A of this Act, or

(2) Offers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading (when the person buying the security does not know of the untruth or omission, and who in the exercise of reasonable care could not have known of the untruth or omission) is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six per cent (6%) per year from the date of payment, less the amount of any income received on the security upon the tender of the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender less (a) the value of the security when the buyer disposed of it and (b) interest at six per cent (6%) per year on such value from the date of disposition. Nothing herein shall prevent the award of punitive or exemplary damages in an amount not to exceed twice the actual damages, as found by the jury, when such false representation or omission is proven to be willfully made.

REASONS FOR GRANTING THE WRIT

Although this is a small case in terms of dollars (Sibley subscribed to $10,000 of Computer stock), the questions presented are extremely important in terms of misconstruction and misapplication of federal law. Obviously, there can be no enforceable subscription agreement under Texas law when the federal securities acts would declare the agreement voidable at Sibley's option.

Although the registration provisions of the 1933 Securities Act are not of great importance to the outcome of this case, the provisions of Section 12 of the 1933 Securities Act are. One of

the most disturbing portions of the opinion of the Texas Court of Civil Appeals is contained in the final two paragraphs of that opinion, the language of which suggests that the provisions of the Federal Securities Acts and the Texas Securities Act are basically the same and that any result reached under the application of one will necessarily be reached by applying the other. The suggestion indicates a misunderstanding of the Federal Acts cited, and the opinion of the Texas Court of Civil Appeals, if allowed to stand, will provide continued misdirection and confusion in Texas Jurisprudence in the broad area of securities regulations.

Using such opinion as a guideline, an attorney could properly advise a client who is preparing to sell unregistered securities that he may safely proceed to do so, provided (1) he sells to no more than thirty five (35) Texas residents, (2) without the use of newspaper or television advertisements, particularly if (3) the buyer has made other investments, without regard to the nature of his business, and (4) some opportunity is allowed the buyer to discover (through his own diligent efforts) and inquire about all material facts which may not have been disclosed to him. He can further advise the potential seller that it makes little difference what is disclosed to the buyer, since the burden is on him (the buyer) to determine whether or not all the information which should be given him has been given him. The buyer, the attorney may justifiably advise, is the one who must decide, based upon what you do or do not disclose to him, everything which is material, relevant, important or useful that the seller failed to furnish to him, so be sure to provide as little information and as few facts as you can get away with and still make the sale. It is up to him, the buyer, to ferret out any and all

pertinent facts which you choose not to disclose.

This court has clearly and consistently negated this rather primitive approach. The failure to disclose essential facts about the merits of the investment (not to mention affirmative misstatements) is the crux of this case. The opinion in *S.E.C. v. Ralston Purina Company*, 346 U.S. 119, decided over twenty (20) years ago has been consistently followed in more recent Fifth Circuit decisions, such as *Hill York Corporation v. American Internatonal Franchises, Inc.*, 448 F. 2d 680 (5th Cir. 1971); *Henderson v. Hayden Stone, Inc.* 461 F. 2d 1069 (5th Cir. 1973); *S.E.C. v. Continental Tobacco Company of South Carolina, Inc.* 463 F. 2d 137 (5th Cir. 1972). This Court, (the Texas Court of Civil Appeals opinion to the contrary notwithstanding), as stated in the *Ralston Purina* case, *supra*, rejects the number of investors involved as a test to determine whether or not a public offering was made, stating that "no particular numbers are prescribed. Anything from two (2) to infinity may serve; perhaps even one." The person receiving the offer, in addition, must be able to "fend for himself" before the offering in question is not a public offering. The Texas Court of Civil Appeals decided that since Sibley had made some investments in the past that he was, per se, able to "fend for himself."

The Defendants in the *Hill York* case, *supra*, would have been very happy to be before the Texas court, since the offerees in the *Hill York* case were sophisticated businessmen and lawyers, armed with a degree of sophistication far greater than Sibley.

The *Hill York* opinion hit the very point the Texas Court of Civil Appeals missed: that the availability of an exemption

simply does not depend on the sophistication of the buyer, but rather on the buyer's possession of or access to information regarding the seller. And the same sound reasoning applies here, quoting the Court: "Obviously, if the (Petitioner) did not possess the information requisite for a registration statement, (he) could not bring (his) sophisticated knowledge of business affairs to bear in deciding whether or not to invest in (Respondent's business)." The burden, in every single case, is placed correctly upon the seller to affirmatively show that he has complied in all respects with the requirements of the applicable securities law; and in each case noted here, the buyer was provided with substantially more information than was Sibley.

Therein lies, probably, the most glaring and substantial difference between the Texas Securities Act and the Federal Securities Law provisions in question. Under the State Act, the burden of proof lies on the buyer to prove a violation under the Act. Under Section 12(2) of the Securities Act of 1933, the burden is expressly placed upon the seller, where it belongs, to prove his compliance with the Act. Once the buyer has shown a misstatement or omission of material fact, the burden falls squarely upon the shoulders of seller.

The Texas Court of Civil Appeals insisted that Sibley failed to show that any material facts were omitted, and this is nothing short of shocking, in light of the fact that the evidence was undisputed that no material facts were provided to Sibley in the first place. The question, then, is, what is material? Again, the Supreme Court of the United States provides the answer in *Affiliated Ute Citizens of Utah v. United States,* 92 S. Ct. 1456, 1472 (1973):

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. *All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision.* See Mills v. Electric Auto-Lite Co., 396 U.S. 375, 348, 90 S. Ct. 616, 621, 24 L. Ed. 2d 593 (1970); Securities & Exchange Commission v. Texas Gulf Sulphur Co., 401 F 2d 833, 849 (CA 2 1968), cert. den sub nom. Coats v. Securities & Exchange Commission, 394 U.S. 976, 98 S. Ct. 1454, 22 L. Ed. 2d 1756 (1960); L. Loss, Securities Regulation, 3876-3808 (Supp. 1969); A. Bromberg, Securities Law, Fraud — SEC Rule 10b-5, pts. 2.6 and 8.6 (1967). This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact. Chasins v. Smith, Barney and Co., 438 F 2d. at 1172." (Emphasis added)

See also *Mills v. Electric Auto-Lite Co.* 396 U.S. 375 (1970).

It is painfully obvious that a reasonable investor might have considered items such as promoters' profits, conflicts of interest, names and backgrounds of officers and directors, salaries of key employees, number of shares of outstanding and issued stock, number of shares authorized but unissued, outstanding options, amount of capital accumulated and general financial condition, important in deciding whether or not to invest in the venture under consideration.

It is unbelievable that the Texas Court of Civil Appeals even went so far as to state that the "Confidential Memorandum" was not materially deficient. 505 SW 2d at p. 420. This court should examine that document for itself. (Appendices A and B)

CONCLUSION AND PRAYER

It is abundantly clear that the Texas Courts have embraced a doctrine which is diametrically opposed to the clear guidelines established by this court under the laws of the United States in the application of Section 12(2) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 promulgated thereunder. To permit this state of the Texas law to continue is, in Sibley's opinion, to permit the continuance and encourage the frequency of both intentional and unwilling violations of the Federal Securities Act through the sale of unregistered securities.

Sibley prays that this Petition for Writ of Certiorari be granted; that the judgments of the Texas District Court, the Texas Court of Civil Appeals, and the Texas Supreme Court be overruled; and that judgment be rendered that Horn take nothing as against Sibley; and that Sibley recover his costs of suit and appeal.

Respectfully submitted,

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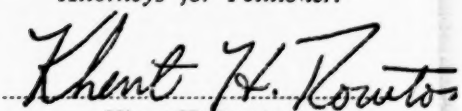

Khent H. Rowton

CERTIFICATE OF SERVICE

A true copy of the foregoing Petition for Writ of Certiorari has this day been served upon the Horn Advertising, Inc. by placing same in the United States Mail, postage prepaid, addressed to WILLIAM M. JONES, 5025 North Central Expressway, Dallas, Texas 75205, Attorney for Respondent.

Khent H. Rowton

Khent H. Rowton

APPENDIX

APPENDIX

APPENDIX A

Confidential Memorandum
Computer Saver Service
Dallas, Texas

The following is an analysis of Computer Saver Service, Inc., the reason for its need, the program and the filling of a need, potential return, method of financing and the speculation involved.

Middle Income America is growing. There are 200,000,000 Americans with 60,000,000 to 70,000,000 taxpayers. The average family income is $8,000-$10,000 per year with the average family living cost of $7,329. Out of this average family budget of $7,329 approximately 30% is spent for food, 6% for medical and dental, 11% for transportation, 13% for clothing and personal care, 22% for shelter and the remainder being spent in a catagory called miscellaneous. Within the scope of the catagory called miscellaneous the average Mr. Taxpayer is bombarded with many requirements for his money, some of which are utilities, recreation, entertainment, donations, insurance, maintenance, home furnishings and the biggest bombardment of all — taxes.

Consequently, because of all these factors the average American taxpayer has all the ariable money and tax problems of a large corportaion without the professional economics and tax guidance of a corporate expert. The taxpayers lack of money management knowledge is known to result in higher divorce rate, lack of good tax records, lost or fragmented tax records, paying more taxes than necessary, lack of a measuring stick in his spending, frustrating budget attempts, financial chaos for newlyweds, higher bankruptcy rates, repossession, too many luxury purchases, no left-over funds for savings or investments, the paying of high interest rates due to constantly

having to refinance excess purchasing. However, most taxpayers realize that they do need financial guidance to place the family economics on a business-like basis and to save on the over-spending of tax dollars. With these needs in mind Computer Saver Service, Inc. was designed. It is a fast and economical method to insure tax savings and good family money management.

Computer Saver Service is a computerized summation of personal monthly income and expenditures, or in other words, a personalized P & L statement for the average American.

Features of the report are current month's income, current month's expeditures, per cent of income to each expenditure, per cent of income and expenditure versus the national averages, per cent to date for the year, year-to-date totals, a monthly "journal" giving:

1. Description of individual check
2. Check number or cash
3. Current month's check amount, year-to-date check amount, plus financial planning advice, tax savings advice, special savings coupons, timely market produce information

The basic benefits of the Computer Saver Service programs are:

1. Tax savings, basically through better, more available records, thereby reducing the unnecessary payment of excess taxes; also the cost of the basic service itself is thought to be either in part of in whole a tax deductible item
2. Money management — simplified listing of P & L, measuring stick to judge individual spending, variations from the norm; promotes better record keeping; should

pay for itself in both improved money management and tax savings

3. Consumer assistance, product discounts, tax savings on services, market advise for season and location

Seeing the need that does exist for the type services that would be provided by Computer Saver Service, Inc., we have outlined the following plan of marketing and promotion.

Since this would be a consumer orientated product rather than a business or a company orientated product, obviously the best media for reaching the largest number of people is television. With this in mind we are laying down a television program with a mixture of productions and a talk type commercial, possibly given by Paul Harvey or some other nationally known spokesman. We will augment this program with drive-time radio advertisement also done by a nationally known spokesman. We feel like because of the unique interest and universal appeal of what we are attempting to do, we will be able to generate magazine, newspaper, as well as radio-TV network interview type promotion. The basic marketing and promotional program is something as follows:

Beginning approximately January 1, 1970, utilizing the four television channels in the Dallas-Ft. Worth area, we would begin a saturation campaign reaching approximately 2,500,000 people. We would also be using the drive-time radio slot for the saturation campaign. At the end of three weeks of this type of advertising a personalized letter done on a local computer would be sent to 100,000 lower, middle and upper middle taxpayers. Television and radio campaign would continue for one week while the letters were being mailed and received, then there would be a decided drop to just a reminder spot of advertising daily while we awaited the results of the initial marketing test. The anticipated cost of the initial test program is $40,000 - $50,000. The financing plan calls

for the issuing of 40,000 shares of stock at $1.00 per share together wtih a contract agreeing to loan to the corporation an additional $4,000 for each 2,000 shares purchased upon an agreement by stockholders that we would move into an expansion program. This would occur approximately February 10, 1970. The planned expansion would be the day that the initial test market was judged to be a success, based on a given return ratio, we would immediately begin advertising in ten additional major metropolitan areas. The same test program would be carried out in those areas at an approximate cost of $50,000 per area. Should this phase two campaign prove to be successful based on a return ratio, we would complete out national saturation campaign by opening up fifteen additional offices. This would give us a very ambitious goal of opening up twenty-five offices in approximately ninety days time. The projected return possibility would indicate that if we were to achieve only forty percent of our anticipated profit ratio and were able to penetrate two percent of the existing market, a two percent stockholders investment could earn approximately $30,000 per year. The basic return ratio is on a $40,000 promotional start-up cost. If we achieve four percent of the mailing pieces in return, we would get $30,000 back in set-up charges. Our projected first month's profit on 4,000 accounts would be plus $9,000. This would mean at a 4% of the mail pieces return, we would return our initial set-up cost approximately forty days after the investment. The individual profit structure calls for a subscriber fee of $6.00 per month with a direct cost of $3.67, giving us a gross profit of $2.33 before administrative overhead. Although we feel the possibilities for this type of an organization to succeed are extremely good and that obviously the corporation is a success, it can generate immense volumes of gross revenue as well as an outstanding net profit on operations. There is obviously an outstanding risk involved.

First, to the best of our knowledge, no one has ever attempted to market this type of a program. Therefore we have no assurance whatsoever that the public will be responsive to the program, nor do we have any assurance whatsoever that if they are responsive we would be successful in holding the customer to the service in as much as there are no contracts, the customer pre-pays and is free to cancel at any time he chooses. Any investment in this corporation must therefore be considered highly speculative with the possibility of the entire investment having to be written off as early as the middle of February, 1970. There are many factors about public acceptance of this type of product that are totally unknown, although we feel like that in the history of time, together with people acceptance of computers, people acceptance of the fact that much of their information is no longer confidential and people acceptance that they are paying more taxes than they should, we stand an excellent chance of success. But again, there are many factors that we cannot judge or survey that will tell us what the general public's reaction would be to this type of program.

APPENDIX B

George W. SIBLEY, M. D., Appellant,
v.
HORN ADVERTISING, INC., Appellee.

No. 18248.

Court of Civil Appeals of Texas,
Dallas.
Jan. 24, 1974.

Rehearing Denied Feb. 21, 1974.

Action to enforce stock subscription. The 192nd District Court, Dallas County, Snowden M. Leftwich Jr., J., found for plaintiff and subscriber appealed. The Court of Civil Appeals, Guittard, J., held that stock subscription was exempt from registration and that there was no showing of omission of material information which would preclude enforcement of subscription.

Affirmed.

1. Securities Regulation

Where stock was offered to no more than 20 persons by promoters who were personally acquainted with one of two promoters, and subscriber was experienced investor "public solicitation" and offering was within statute exempting sales of security to no more than 35 persons from state registration requirements. Vernon's Ann.Civ.St. art. 581-5, subd. I.

See publication Words and Phrases for other judicial constructions and definitions.

2. Securities Regulation

Confidential memorandum, which explained corporation's business and method of financing same, and advertising piece

prepared for mailing to prospective customers were not "advertisements" within statute exempting firm registration stock offerings which did not involve more than 35 persons provided sale was made without public solicitation or advertisements. Vernon's Ann.Civ.St. art. 581-5, subd. I.

See publication Words and Phrases for other judicial constructions and definitions.

3. Securities Regulation

Term "advertisements" as used in statute exempting stock offerings which do not involve more than 35 investors provided sale is accomplished without advertisements implies public distribution. Vernon's Ann.Civ.St. art. 58-5, subd. I.

4. Securities Regulation

Where subscriber to stock did not show how any statement made to him was rendered misleading because of failure to disclose relevant information, it could not be said that subscription was unenforceable because of failure to disclose material facts. Vernon's Ann.Civ.St. art. 581-33, subd. A(2).

5. Securities Regulation

Where subscriber to stock who was sued on subscription did not set forth specific items which promoters of stock failed to disclose, plaintiff was not required to show affirmatively that information was disclosed or that it was not material. Vernon's Ann.Civ.St. art. 581-33, subd. A(2).

6. Securities Regulation

Record in suit to enforce stock subscription failed to establish that disclosure of options to purchase stock held by promoters were material or necessary to keep information given from being misleading. Vernon's Ann-Civ.St. art. 581-33, subd. A(2).

7. Securities Regulation

Federal statutes and regulations relating to stock subscription do not impose liability for omissions per se. Securities

Act of 1933, § 12(2), 15 U.S.C.A. § 77l(2); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

8. Securities Regulation

Record in suit to enforce stock subscription failed to establish that promoters violated any federal laws relating to stock subscriptions. Securities Act of 1933, § 12(2), 15 U.S.C.A. § 77l(2); Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

John D. Gilliland, Vaughan, Gilliland & Cates, Dallas, for appellant.

Bill Jones, McKool, Jones, Shoemaker & Vassallo, Dallas, for appellee.

GUITTARD, Justice.

This case involves the small-offering exemption of the Texas Securities Act and the disclosure requirements of both Texas and federal securities acts. We hold that the offering in question was exempt from registration and that nondisclosure of material information has not been established.

The suit was brought on a subscription agreement for $10,000, the amount subscribed by defendant to stock in a new corporation. Defendant pleaded invalidity of the transaction because of failure to register the stock with the Texas Securities Commissioner and because of misrepresentations and failure to disclose material information required by both state and federal acts. The misrepresentation issue was tried to a jury, and no misrepresentation was found. No other issues were submitted. Defendant moved for judgment notwithstanding the verdict on the ground that the agreement was invalid as a matter of law because of failure to register and failure to disclose material information. The trial court overruled this motion and rendered judgment against defendant for the amount subscribed. We affirm.

The facts on this aspect of the case are without substantial dispute. Keith Laseter and Robert Fanning, an attorney, were promoters of Computer Saver Services, Inc., a corporation organized for the purpose of providing a computerized bookkeeping service for personal financial affairs. The principal expense projected for beginning the business was for an advertising campaign, and the primary purpose of selling stock was to raise money for the campaign. No more than twenty prospective subscribers were contacted. Each of these prospects, including defendant, was personally known to Fanning, who contacted them by telephone and made appointments for Laseter to see them. Laseter was president of the corporation. He presented to each of the prospects a four-page, typewritten "confidential memorandum" explaining the need for the service, the method of operation, the proposed advertising program, the method of financing, the projected returns, and an explanation of the speculative nature of such an untried venture. Laseter used a "flip chart" in presenting to the prospects the material contained in the "confidential memorandum," and he also showed the prospects an advertising piece prepared for mailing to prospective customers. Laseter testified that he made the same presentation to defendant George W. Sibley.

Defendant Sibley, a physician, testified that he first learned about Computer Saver Services, Inc., from Fanning in Fanning's office, that Fanning recommended Laseter, who subsequently came to see him, that he talked to Laseter between patients, that while Laseter was there he called Fanning on the telephone and talked with him about the venture, that he had had previous dealings with Fanning and thought Fanning was acting in his interest and doing him a favor, and that he signed the agreement without reading it and without seeing the "confidential memorandum." Defendant testified further that he was familiar with securities and stock transactions

from his own personal investments, that he had been involved in privately held or closed corporations, that he had other dealings with Fanning in a privately held corporation, and that he had had maybe a thousand business transactions since leaving medical school. The stock in question was not registered with either the Texas Securities Commissioner or the Securities and Exchange Commission. According to Laseter, both he and Fanning had options to purchase additional shares. These options were not mentioned in the "confidential memorandum," and defendant testified that he did not know about them.

All but one or two of the prospects solicited signed subscription agreements, and all paid except defendant. A total of $65,000 was raised, of which $40,000 was spent on advertising. The venture was not successful, however, and the corporation folded. Defendant never paid his subscription, which was assigned to plaintiff, an advertising agency which had participated in the campaign.

1. *Registration under Texas Securities Act*

Our first question is whether the stock mentioned in the subscription agreement was exempt from registration under § 5(I) of the Texas Securities Act, Tex.Rev.Civ.Stat.Ann. art. 581-5(I) (Vernon 1964), which provides that the Act shall not apply to sale of any security by the issuer so long as the total number of security holders does not exceed thirty-five persons, "[p]rovided such sale is made without any public solicitation or advertisements." The Act contains no definition of "public solicitation" or "advertisements." In Tumblewood Bowling Corporation v. Matise, 388 S.W. 2d 479 (Tex.Civ.App.—Beaumont 1965, writ ref'd n. r. e.) an offering of stock to two hundred and fifty people, of whom less than thirty-five purchased, was held to be a "public solicitation." The court said that this term does not mean that the offer must be made to

the entire world, citing SEC v. Ralston Purina Co., 346 U.S. 119, 73 S.Ct. 981, 97 L.Ed. 1494 (1953), in which a similar interpretation was given to the exemption for transactions "not involving a public offering" in § 4(1) of the Securities Act of 1933, 48 Stat. 77 as amended, 48 Stat. 906 (now found in 15 U.S.C.A. § 77d(2) (1971)). In that case the Supreme Court denied the exemption to an offering limited to employees of a large corporation, several hundred of whom purchased stock each year, saying that the Act must be construed in the light of its purpose to protect potential investors by promoting full disclosure of information necessary to informed investment decisions, and that applicability of the exemption should turn on whether the particular class of persons affected needs the protection of the Act. Illustrating this construction, the Court observed: "An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.' "

[1] We hold that a similar construction of "public solicitation" in the Texas Act is proper and brings this case within the exemption. Defendant was solicted because of his personal acquaintance with attorney Fanning, and he agreed to buy the stock because of that relationship. He was "able to fend for himself" since he was an experienced investor and had personal experience with Fanning in privately-held corporate ventures. The offering was limited, and defendant was a major subscriber. He was dealing directly with Laseter, the president of the corporation, and was in contact with Fanning, the other principal promoter. He had ample opportunity to pursue with them whatever inquiry he considered necessary to an informed investment decision. Apparently he was not satisfied with the information presented by Laseter, but called Fanning and obtained his personal assurance about the venture. The jury found that Fanning made no misrepresentation, and defendant

does not attack that finding. We conclude that these circumstances do not establish a "public solicitation."

[2, 3] We hold also that the "confidential memorandum" and other written materials used by Laseter were not "advertisements" within the meaning of § 5(I). The materiality of the "confidential memorandum" is questionable, since defendant testified that he never saw it, but even if we disregard his testimony in that respect, the most his evidence shows is that the material was presented in personal interviews to no more than twenty selected acquaintances of one of the promoters. Thus, the case differs from *Tumblewood, supra,* in which the term "advertisement" was held applicable to a brochure exhibited to two hundred and fifty prospects not previously known to the salesman who solicited them. That holding is discussed by Professor Alan Bromberg in Texas Exemptions for Small Offerings of Corporate Securities — The Prohibition on Advertisements, 20 S.W.L.J. 239 (1966). We agree with Professor Bromberg's view that "advertisement" implies public distribution, and that to apply the term to all written information presented to a prospective purchaser of securities would defeat rather than promote the purpose of the Act to require disclosure of material information because such a holding would grant the private offering exemption only to oral communications, which would normally be less informative than written communications. Unlike the brochure in *Tumblewoods,* the record here failed to show any public distribution of the material in question.

2. *Nondisclosure under Texas Securities Act*

Defendant also contends that even if the stock was exempt from registration, the subscription agreement was unenforceable because of failure to disclose material facts, in violation of § 33(A)(2) of the Act. Tex.Rev.Civ.Stat.Ann. art 581-

33(A)(2) (Vernon 1964). This section imposes civil penalties upon any person who

> [o]ffers or sells a security (whether or not the security or transaction is exempt under Section 5 or 6 of this Act) by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made not misleading.

Defendant's answer alleges the following omissions of material facts:

> (1) the failure to give Defendant any written or oral information concerning the company's operation, scope and nature of business; (2) the failure to give Defendant any written or oral information concerning the financial status of the corporation; (3) failure to inform Defendant that the corporation was solvent at the time of its offer of the securities to Defendant; (4) failure to disclose to Defendant the fact that the corporation had offered and sold similar securities issued by it to other individuals besides the Defendant, when in fact Plaintiff's assignee [sic] had sold to at least eight or nine different individuals securies issued by the corporation similar to those described in the alleged subscription agreement in question; (5) failure to disclose to Defendant the terms upon which such third parties purchased or agreed to purchase the corporation's securities; and (6) failure to disclose that said parties who purchased or agreed to purchase securities of the corporation included both residents of Texas and non-residents of Texas.

[4] Defendant does not allege, nor does he point out here, any statement made to him that was rendered misleading because of absence of information alleged to have been omitted. We do not see how any of the facts alleged to have been omitted would have served to prevent a misleading in-

terpretation of the information given. The "confidential memorandum," if defendant saw it, cannot be considered misleading in this respect because it provides most of the information alleged to have been omitted. It shows that the business was an entirely new and speculative venture, describes the plan of operation, and explains that it is to be financed by issuance of 40,000 shares of stock at $1.00 per share with an agreement of the subscribers to loan to the corporation $4,000 for each 2,000 shares purchased. On the basis of the evidence before us we hold that none of the matters alleged in the answer is shown as a matter of law to be an "omission to state a material fact necessary in order to make the statements made not misleading" within § 33.

[5, 6] Other omissions are mentioned in the briefs and in the motion for judgment notwithstanding the verdict, such as the options held by Fanning and Laseter to purchase stock, but since these matters were not alleged in the answer, plaintiff was not required to show affirmatively that the information was disclosed or that it was not material. Apart from the lack of pleading, the record does not show as a matter of law that these matters were material or that they were necessary to keep the information given from being misleading. Consequently defendant has failed to establish that the trial court erred in overruling his motion for judgment notwithstanding the verdict.

3. *Nondisclosure under federal securities acts*

[7, 8] Defendant also asserts that the subscription agreement was unenforceable under § 12(2) of the Federal Securities Act of 1933, 15 U.S.C.A. § 77l(2) (1971), and Rule 10b-5 (13 Fed.Reg. 8177) promulgated by the Securities and Exchange Commission under authority of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.A. § 78j(b) (1971).

Section 12(2) of the 1933 Act forbids the use of the mails or any means of communication in interstate commerce to offer or sell any security "by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading." A similar prohibition is contained in Rule 10b-5. We see no substantial difference between these provisions and the language of § 33 of the Texas Securities Act above discussed. They do not impose liability for omissions *per se*. 3 L. Loss, Securities Regulation 1702 (1916). For reasons already given with respect to the Texas Act, we hold that defendant has failed to establish as a matter of law a violation of either of the federal acts.

No issue is raised here concerning failure to comply with the registration requirement of the federal acts, since it is undisputed that the issuer in this case was a Texas corporation doing business in Texas and that the stock was offered and sold only to residents of Texas, within the exemption of § 3 of the 1933 Act, 15 U.S.C.A. § 77c(a)(11) (1971).

Affirmed.

APPENDIX C

IN THE SUPREME COURT OF TEXAS

June 26, 1974

No. B-4556.

George W. Sibley, M. D.

v.

Horn Advertising, Inc.

From Dallas County, Fifth District.

Application of petitioner for writ of error to the Court of Civil Appeals for the Fifth Supreme Judicial District having been duly considered, and the Court having determined that the application presents no error requiring reversal of the judgment of the Court of Civil Appeals, it is ordered that said application be, and hereby is, refused.

It is further ordered that applicant, George W. Sibley, M.D., and his surety, Fidelity and Deposit Company of Maryland, pay all costs incurred on this application.

July 24, 1974.

No. B-4556.

George W. Sibley, M. D.

v.

Horn Advertising, Inc.

From Dallas County, Fifth District.

Petitioner's motion for rehearing of application for writ of error having been duly considered, it is ordered that said motion be, and hereby is, overruled.

I, GARSON R. JACKSON, Clerk of the Supreme Court of Texas, do hereby certify that the above and foregoing is a true and correct copy of the orders of the Supreme Court of Texas in the case numbered and styled as above, as the same appears of record in the minutes of said Court under the dates shown.

WITNESS my hand and the seal of the Supreme Court of Texas, at the City of Austin, this, the 19th day of September, 1974.

GARSON R. JACKSON, Clerk

By/s/ Eugene Cervenka

Deputy.